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SUBJECT: STRONGER THAN EXPECTED 2003 GDP GROWTH; MIXED  
VIEWS ON 2004

1. (SBU) Summary: Final numbers released March 31 show Turkey's GNP grew 5.9 percent in 2003, well above the market consensus forecast of 5.2 percent. For 2004, there is a significant divergence of views among Turkish economists -- both inside and outside the GOT -- with some forecasting growth as low as 4 percent and others more bullish. End Summary.

Statistical Agency announces higher-than-expected 2003 growth...

2. (U) On March 31, the State Statistical Agency announced final 2003 GDP and GNP growth rates of 5.8 and 5.9 percent, respectively. With the market consensus for GNP at 5.2 percent and the target under the IMF program only 5.0 percent, the announced growth rates were a positive surprise. Strong fourth quarter growth rates of 6.1 and 7.2 percent for GDP and GNP caused the full-year numbers to come in higher, led by strong growth in the industrial and non-construction services sectors.

...Especially in the Industrial Sector and the Trade Component of Services:

3. (SBU) Within the sectoral breakdown of growth data, the industrial sector, along with services trade, showed the strongest fourth quarter growth, with each enjoying a 9.2 percent increase over fourth quarter 2002. Although construction declined 9.0 percent for the full year, it grew 1.3 percent in the fourth quarter, suggesting that this hard-hit sector may finally be emerging from its downturn. Although a growing current account deficit served as a drag on growth, the continued strength of exports -- despite the strong Lira -- prevented trade from weighing down growth even more.

4. (SBU) Istanbul-based Deutsche Bank economist Tefvik Aksoy was among the more bullish -- and, therefore, accurate -- forecasters of fourth quarter 2003 growth, with a 5.8 percent prediction. In a meeting with econoff March 26, Aksoy made the case that the export sector was not as badly hurt as one might expect because many exporters' inputs are Asian-sourced and dollar-denominated, whereas these companies' sales to Europe are Euro-denominated. Although the Lira has appreciated against the Euro as well as the dollar, it has appreciated substantially more against the latter. Though Aksoy said the overvaluation of the Lira was comparable to pre-crisis 2000 levels, there has been a 30 to 35 percent gain in labor productivity which has acted as a brake on the deterioration of the trade balance. Aksoy also said that Iraq has been wonderful for Turkey's leading white goods and electronics producers, Beko, Arcelik, and Vestel.

Local Economists' Mixed Views on the 2004 Growth Outlook:

5. (SBU) In recent meetings with us, senior GOT economic technocrats, Treasury U/S Ibrahim Canakci, State Planning Organization U/S Ahmet Tiktik, and his Deputy Birol Aydemir all were predictably optimistic on growth. Aydemir even went so far as to worry about overheating, saying he had disagreed with the IMF on the issue, and citing a 170 percent increase in consumer loans in 2003. Tiktik (like most private economists) was less worried about overheating, though he

noted a surge in consumer credit-financed consumer goods purchases with a high import content -- a potential drain on growth. On the other hand, he predicted a strong year for the important agricultural sector, which tends to be strong in alternate years and is due for a good year in 2004. The data seem to support Tiktik: the Agriculture component of GNP shrank 2.5 percent in 2003, following a 6.9 percent increase in 2002.

16. (SBU) In meetings with private economists in Istanbul March 26, growth expectations were more of a mixed bag. Deutsche Bank's Aksoy and Citigroup's Olgay Buyukkayali tended more to the bullish side. Buyukkayali even acknowledged that Aydemir's concerns about overheating had a theoretical basis, but were probably premature. Buyukkayali, like Aksoy, accurately predicted the strong 2003 GDP growth figure, and forecast 2004 growth in line with the program target of 5 percent.

17. (SBU) There are some bears, however. Murat Ucer of Eurosource, a former IMF staffer and one of the few private economists not affiliated with a financial institution, expects growth of only 4 percent in 2004, well below the IMF program's 5 percent target and at a level unlikely to produce any growth in employment. Ucer bases his pessimism on the base effect of stronger growth in 2003 and on the absence of investment. He and his colleague Atila Yesilada were pessimistic about medium-term growth because of the absence of structural reforms and the inability of the Turkish leadership to recognize that they were in a global race and needed to take radical action about things like expanding English language instruction and computer usage, and finding a way to reduce tax rates.

18. (SBU) Likewise, Sinan Gumusdis of JP Morgan/Chase told econoff March 26 that Morgan's economists had recently downgraded their 2004 growth forecast from 5 percent to 4.5 percent. Gumusdis believes that some of the recent growth derived from pent-up demand from the crisis period which is likely to lessen in 2004. John McCarthy of ING Barings, an American banker with long experience of Turkey, told econcouns he did not see any surge in consumer demand. Earlier, Birol Aydemir of State Planning said the lack of increased domestic consumption is a result of the GOT's restrictive incomes policy under its tight fiscal policy. That's why, according to Aydemir, it was so critical that the private sector increase investment, a prospect about which McCarthy was notably pessimistic, pointing out that some foreign companies in Turkey, such as ING, were actually disinvesting.

#### Unemployment Worries:

19. (SBU) While the better-than-expected growth numbers are encouraging, the mixed views on the growth outlook contrast with a pessimistic consensus on employment issues. Across the spectrum of economists and bankers, worries about unemployment and underemployment abound. Aydemir noted the "social risk" arising from very high rates of unemployment (25 percent) among educated young people. Gumusdis did not foresee a pick-up in employment. Yesilda also noted that two or three million Turks work for only \$100 or \$200 dollars a month. At this income level, "they only eat" and can't spend any money on durable goods. Separately, a survey conducted by TESEV, the Turkish Foundation for Economic and Social Studies, indicated that unemployment has replaced inflation as the public's most important concern, though it also found Turks more optimistic about economic progress than in the past three years.

110. (SBU) Comment: One wild card on growth is Iraq. Data indicates Turkish exports to Iraq are surging, and we see significant anecdotal evidence that Iraq's reconstruction will be a boon to the Turkish economy. It is hard to predict how much Iraq will contribute to Turkish growth in 2005, but little doubt the impact will be positive.

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